

Message Text

CONFIDENTIAL

PAGE 01 LISBON 02892 01 OF 02 171542Z
ACTION EUR-12

INFO OCT-01 ISO-00 SSO-00 NSCE-00 INRE-00 ICAE-00
SP-02 AID-05 EB-08 TRSE-00 SS-15 STR-07 OMB-01
CEA-01 L-03 H-01 PA-01 CIAE-00 COME-00 FRB-03
INR-10 NSAE-00 XMB-02 OPIC-03 LAB-04 SIL-01 /080 W
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O R 171357Z APR 78
FM AMEMBASSY LISBON
TO SECSTATE WASHDC IMMEDIATE 5461
INFO AMEMBASSY BONN

C O N F I D E N T I A L SECTION 1 OF 2 LISBON 2892

DEPT. PASS TREASURY FOR SYVRUD

E.O. 11652: XGDS-3
TAGS: ECON, EFIN, PO
SUBJECT: PORTUGAL-IMF NEGOTIATIONS

REF: LISBON 2794

BEGIN SUMMARY. DURING PRIVATE CONVERSATION APRIL 15, MINISTER OF FINANCE CONSTANCIO INDICATED TO ME THAT GOP AND IMF ARE FAIRLY CLOSE TO AN AGREEMENT. THEY REPORTEDLY REACHED ACCORD ON A CREDIT EXPANSION CEILING OF ABOUT 130 BILLION ESCUDOS. CONSTANCIO FEELS IMF WILL EVENTUALLY ACCEPT GOP PROPOSAL FOR AN AVERAGE INCREASE OF 4 PERCENTAGE POINTS IN INTEREST RATES. BOTH SIDES AGREE THAT ESCUDO PRICES OF IMPORTS SHOULD RISE BY 27 PERCENT IN DOLLAR TERMS THIS YEAR, BUT THEY DIFFER ON THE LEVEL OF ESCUDO DEVALUATION REQUIRED TO ACHIEVE THAT TARGET. CONSTANCIO, APPARENTLY CONSIDERING A SECOND TRANCHE FUND AGREEMENT AS A VIRTUAL FAIT ACCOMPLI, IS STARTING TO FOCUS ON PORTUGAL'S 1979 EXTERNAL FINANCING REQUIREMENTS. WE STRESSED THAT GOP SHOULD CONCENTRATE ON SUCCESSFULLY CONCLUDING PRESENT FUND NEGOTIATIONS. END SUMMARY.

CONFIDENTIAL

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PAGE 02 LISBON 02892 01 OF 02 171542Z

1. ECON COUNSELOR AND I MET WITH MINISTER OF FINANCE CONSTANCIO SATURDAY, APRIL 15. MINISTER STATED THAT, FROM GOP VIEWPOINT, THE FRAMEWORK OF AN IMF AGREEMENT IS FALLING INTO PLACE. FUND MISSION CHAIRMAN SCHMIDT WAS SCHEDULED TO GO TO WASHINGTON ON APRIL 15 FOR CONSULTATIONS AND TO RETURN TO LISBON APRIL 19. CONSTANCIO OUTLINED STATUS OF MAJOR ISSUES AS FOLLOWS:

A. CREDIT CEILING: GOP AND IMF HAVE AGREED IN PRINCIPLE ON CREDIT EXPANSION CEILING. CONSTANCIO AVOIDED PROVIDING A FIRM FIGURE BUT SUGGESTED ONE OF "ABOUT 130 BILLION ESCUDOS." (COMMENT: EVIDENTLY DETERMINATION OF SPECIFIC FIGURE DEPENDS SOMEWHAT ON FINAL RESOLUTION OF INTEREST RATE AND EXCHANGE RATE ISSUES.)

B. INTEREST RATES: CONSTANCIO FEELS FUND WILL ACCEPT GOP COUNTERPROPOSAL FOR AN AVERAGE FOUR PERCENTAGE POINT RISE IN INTEREST RATES. HE FIRMLY BELIEVES GOP CANNOT IMPLEMENT A LARGER INCREASE WITHOUT SPARKING SERIOUS NEGATIVE PUBLIC OPPOSITION. IN FACT, HE NOTED, CENTRAL BANK GOVERNOR SILVA LOPES IS THE ONLY GOP OFFICIAL WHO SUPPORTS HIM IN PROPOSING A RISE IN INTEREST RATES.

C. EXCHANGE RATES: GOP AND IMF HAVE AGREED THAT ESCUDO PRICES OF IMPORTED GOODS SHOULD RISE BY 27 PERCENT IN DOLLAR TERMS DURING THE PROGRAM YEAR. A DIFFERENCE OF OPINION EXISTS AS TO WHAT LEVEL OF DEVALUATION IS REQUIRED TO REACH THAT TARGET. FUND MISSION MAINTAINED THAT AVERAGE INFLATION RATE FOR MAJOR EXPORTING COUNTRIES WILL BE ZERO IN DOLLAR TERMS. GOP CLAIMS THAT OECD PROJECTS AN AVERAGE INFLATION OF 4.5 PERCENT FOR ITS MEMBERS, AND THAT, IN DOLLAR TERMS THE INFLATION WOULD APPROACH 9 PERCENT. SELECTION OF ONE OR THE OTHER INFLATION PROJECTION WOULD SIGNIFICANTLY AFFECT DEGREE TO WHICH GOP MUST DEVALUE ESCUDO. FUND MISSION CHAIRMAN WILL EXPLORE THIS QUESTION DURING HIS WASHINGTON CONSULTATIONS. (COMMENT: NOTING THAT NO CONFIDENTIAL

CONFIDENTIAL

PAGE 03 LISBON 02892 01 OF 02 171542Z

OBJECTIVE CRITERIA MAY BE ACCEPTABLE FOR RESOLVING THIS ISSUE, WE URGED THAT BOTH SIDES COMPROMISE QUICKLY IF THEY REACH AN IMPASSE.) CONSTANCIO ADMITTED THAT HE STILL HAS SOME DIFFICULTY WITH FUND RECOMMENDATION FOR A DISCRETE DEVALUATION. HE CONCEDED, HOWEVER, THAT ULTIMATELY HE WILL MOST LIKELY HAVE TO ACCEPT THE FUND'S POSITION.

2. CONSTANCIO PLANS TO ASK THE GOP CABINET, DURING TUESDAY, APRIL 18 MEETING, FOR ITS APPROVAL OF THE PROGRAM OUTLINED ABOVE. HE EXPECTS TO ENCOUNTER SOME OPPOSITION. THE CDS MINISTERS, FOR EXAMPLE, ARE LIKELY TO OPPOSE SEVERAL POINTS, PARTICULARLY THE PROPOSAL FOR HIGHER INTEREST RATES. (COMMENT: WE AGREE THAT SOME CABINET MEMBERS MAY RAISE OBJECTIONS. WE BELIEVE, HOWEVER, THAT FIRM LEADERSHIP BY PRIME MINISTER SOARES SHOULD SUFFICE TO GAIN CABINET APPROVAL.) CONSTANCIO CONCURS THAT GOP AND IMF SHOULD REACH FINAL AGREEMENT ASAP. HE WOULD LIKE TO BEGIN IMPLEMENTING THE PROGRAM AND PUBLISH THE LETTER OF INTENT BEFORE IT GOES TO IMF BOARD FOR APPROVAL. FOR POLITICAL REASONS, HE PREFERS NOT TO PUBLISH THE LETTER OF INTENT BEFORE MAY 1.

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PAGE 01 LISBON 02892 02 OF 02 171538Z
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C O N F I D E N T I A L SECTION 2 OF 2 LISBON 2892

3. CONSTANCIO, IN RESPONSE TO AN INVITATION RECEIVED TWO MONTHS AGO, IS PLANNING TO VISIT THE UNITED STATES APRIL 21-23 TO PARTICIPATE IN A SEMINAR SPONSORED BY THE BILDENBERG FOUNDATION OF HOLLAND. HE PLANS TO GO ONLY TO NEW JERSEY NOT TO WASHINGTON. AFTER A DISCUSSION OF POSSIBLE PUBLIC SPECUALTION ABOUT HIS VISIT, HE NOTED REGRETFULLY THAT PERHAPS HE SHOULD NOT TAKE THE TRIP. HE THEN ADDED, ONLY HALF FACETIOUSLY, THAT HE MIGHT CONCLUDE THE IMF AGREEMENT IN PRINCIPLE ON WEDNESDAY, APRIL 19 OR THURSDAY, APRIL 20; DEPART FOR THE U.S. WITHOUT MAKING ANY PUBLIC COMMENT; AND THEN ANNOUNCE ON HIS RETURN TO LISBON THAT AN AGREEMENT HAD BEEN REACHED WITH THE FUND. (COMMENT: ALTHOUGH WE SERIOUSLY DOUBT THAT HE CAN FOLLOW THIS FORMAT, IT SUGGESTS GOP AND IMF ARE INDEED CLOSE TO A TOTAL AGREEMENT.)

4. THE MINISTER THEN MENTIONED THAT THE GOP EXPECTS TO FACE A VERY DIFFICULT BALANCE OF PAYMENTS SITUATION IN 1979. HE CLAIMED THAT THE FUND, WITH ITS VARIED FACILITIES, COULD PROVIDE PORTUGAL WITH \$350 MILLION NEXT YEAR. GOP HAS BEEN CONSIDERING OTHER POSSIBLE SOURCES OF FINANCING SINCE THIS AMOUNT, HE STRESSED, WOULD DEFINITELY NOT MEET PORTUGAL'S NEEDS. CONSTANCIO ASKED WHETHER WE THOUGHT HE SHOULD REQUEST THE PARTICIPANTS IN THE \$750 MILLION LOAN
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PAGE 02 LISBON 02892 02 OF 02 171538Z

PROGRAM TO AUGMENT THEIR CONTRIBUTIONS. WE GAVE HIM AN IMPHATIC NEGATIVE RESPONSE, SAYING THAT GOP SHOULD NOT TAMPER WITH THE \$750 MILLION CONSORTIUM. WE SUGGESTED INSTEAD THAT HE CONCENTRATE NOW ON THE SECOND TRANCHE FUND NEGOTIATIONS AND IMPLEMENTATION OF THE PROGRAM.

5. COMMENT. OUR DISCUSSION WAS ENCOURAGING. GOP AND IMF APPARENTLY MADE SUFFICIENT PROGRESS DURING THEIR APRIL 11-14 MEETINGS TO BRING THEM WITHIN SIGHT OF AN AGREEMENT. HOPEFULLY THE REMAINING TECHNICAL DIFFERENCES CAN BE RESOLVED PROMPTLY. WE SHOULD CONTINUE TO URGE BOTH PARTIES TO PURSUE THEIR DISCUSSIONS, COMPROMISE THEIR DIFFERENCES WHENEVER AN IMPASSE ARISES, AND CONCLUDE AN AGREEMENT ASAP.
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